

## Macro-adjustments in China: experience and lessons

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Since the financial crisis broke out in some Asian countries in mid-1997, it has been widely recognised that strengthening financial supervision and preventing financial risks is crucial to maintaining healthy economic development. Especially under the trend of economic and information globalisation, how to implement effective financial supervision has become an urgent issue that needs to be addressed without delay. There have been a lot of successes as well as painful lessons in this regard at home and abroad. I believe this seminar will play a positive role in contributing to improving financial supervision and regulation and preventing financial risks in China.

Governor Dai's and the distinguished Chinese and foreign experts' speeches have provided very valuable and insightful comments about China's macroeconomic development. These opinions and thoughts will be very helpful in China's efforts to improve macroeconomic performance and promote economic development. In the following, I will share with you my thoughts on the major experience and lessons that we should learn from the macroeconomic adjustments over the past 20 years since China began to adopt the policy of reform and opening to the world.

China's policy of reform and opening to the world has led to rapid economic development, a considerable increase in the country's overall national strength and an enormous improvement in the living standards of its people. These achievements have impressed the world. Nevertheless, it is undeniable that due to a lack of direct experience and readily available foreign experience, we have been fumbling and experimenting in the transition from a planned economy to a socialist market economy. Although there have been some obstacles and setbacks as well as some notable lessons, timely macroeconomic measures adopted by the Chinese authorities have succeeded in avoiding ups and downs in the economy, thereby maintaining the overall stable trend of development.

It is necessary to make an overall review and assessment of the principal experience and lessons of the macroeconomic adjustment over the past 20 years in order to continue to maintain sustainable growth. The following are the ten points that I think worthy of our attention.

First, development is of overriding importance. It is very important that the enthusiasm of central and local governments and the masses be motivated and brought into full play. China has a huge population of 1.2 billion people. China's economy is less developed and will remain in the primary stage of socialist economy for a long time, and thus developing the economy and enhancing social productivity is a long-term challenge facing us. As Deng Xiaoping once pointed out: the key to solving all of China's problems is to depend on self-development. China's economic growth has to rely on our own efforts; our "primary accumulation" has to rely on our own hard work and the wisdom of the people. The only right approach to achieve the goal of economic growth is to mobilise the initiatives of the central and local governments and those of the people at grass-root level. We must work together in our reform and development effort. That is perhaps the most important lesson we have drawn in the past 20 years.

Second, we should facilitate development by reform and ensure that reform is smoothly implemented so that social stability is maintained. Our experience over the past 20 years has proved that the only possible way for China to promote economic development is to continue our reform that has provided great momentum for emancipating economic agents and expanding productivity. Reform is the only way by which China can develop into a rich and strong country so that the people's living standards can be improved. No matter what happens, we should not stop our reform effort. The more economic difficulties we face, the more we should pay attention to straightening out the economic orders and pushing forward with reform measures. Reform and development can doubtless only be achieved in a stable social and political environment, which requires putting the interest of the majority first, forming consensus among the people and making economic development the priority.

Third, macro-adjustment powers should be appropriately concentrated and the powers of economic management should be appropriately dispersed. As the economic system reform and economic development are undertaken simultaneously, the relationships between different

economic factors and social groups are undergoing dramatic changes which can easily cause disturbances in the economy and imbalances between economic factors. Under such circumstances, the powers of macro-adjustment should be appropriately concentrated in the central government so that it can make decisions concerning the big picture and be prepared for potential problems in order to ensure the stable development of the macroeconomy. However, economic management powers should be delegated to the appropriate levels of government according to various economic sectors and affiliations to enable the micro-system to operate independently so that they can adapt to the market changes and the new economic environment.

Fourth, with aggregate demand under control, efforts should be made to improve aggregate supply. China's economy has long been characterised by insufficient supply. The major imbalance in the economy is reflected in the fact that booming aggregate demand and excessive investment demand are running ahead of insufficient aggregate supply. Therefore, it is an important task to bring aggregate demand and aggregate supply into equilibrium. Under most circumstances, balance can be achieved by managing aggregate demand. However, the ultimate solution to the imbalance between aggregate demand and aggregate supply relies on increasing aggregate supply. Therefore, balancing the two aggregates should be tackled with macro-adjustment. For short-term policy such as annual policies, the management of aggregate demand is the focus; while for long-term policy, improving aggregate supply is the overall strategy. In increasing aggregate supply, "to grab anything within one's reach" should be avoided so as to prevent future problems caused by blind development and over-construction.

Fifth, while sticking to moderately tight fiscal policy and monetary policy, it is nevertheless desirable to maintain some flexibility and fine-tune the economy when needed. In the long process of reform, inflation usually becomes the major obstacle to stable economic growth. To control the excessive growth of aggregate demand, attention should be paid to the fiscal balance and the balance between credit demand and credit supply to avoid excessive fiscal deficits and excessive monetary expansion. A moderate balance-of-payments surplus should be maintained. Although, in a relatively long period, positive capital inflows are favourable to a developing country, this net inflow should be kept within reasonable limits and should be mainly in the form of foreign direct

investment. Short-term borrowing from abroad should be undertaken prudently. It is therefore important to follow a moderately tight macro-economic policy to restrain fiscal expenditure and credit extension in order to maintain the overall balance of economic aggregates. However, economic development does not always run smoothly: the same macro-adjustments do not always work. At some times, the policy mix works well. At other times, timely adjustment in fiscal policy and monetary policy is required to facilitate the overall development.

Sixth, it is important to take advantage of the domestic and foreign markets and resources in improving investment conditions and enhancing economic technological exchanges. Against the backdrop of globalisation of the world economy, it is impossible for China to achieve its reform and development strategy without opening to the world. So we should continue to promote foreign trade, attract foreign investments and establish special economic zones within a multi-layer, broad-based framework of reform. It is also important for China to improve economic management and to enhance international competitiveness in order to make full use of our comparative advantage in interactions with foreign countries. In the process of opening to the outside world, we must also pay attention to following international practice, mitigating the effects of external shocks and protecting national economic security. We should promote reform in a positive and cautious way by taking into consideration the economic development of our country.

Seventh, a major aim must be to improve people's living standards while promoting economic growth. The fundamental objective of reform, opening to the world and economic development is to improve the living standards of the people in terms of goods, services and cultural wellbeing. The incentive for reform and development is the improvement of living standards, which may in turn promote the reform and development. When the public can see with their own eyes the positive results of reform and economic growth, it is easy for us to enhance their initiatives and perseverance in the face of difficulties arising from the reform process. Therefore, the reform and economic growth must meet the requirements of increasing living standards. Our goal at the present stage is to raise living standards to a moderate level and to gradually move to higher levels. In addition to raising people's real income, we should also gradually build public facilities and the social welfare infrastructure, improving the quality of education and healthcare. We

should also implement policies to ensure the basic livelihood of people in poverty so that most people will support the reform, actively participate and make their own contribution.

Eighth, the invisible hand (the market) and the visible hand (government intervention) should both play their roles in economic adjustments. The socialist market economy of our country is the combination of the basic socialist system and the market mechanism. The basic requirement of such an economy is to enable the market to perform its basic function of facilitating resource allocation under government regulations. Such a function is irreplaceable and indispensable especially in the behaviour of microeconomic agents. The operation of an economy must take account of the role of prices. However, market self-adjustment is no panacea. The imperfect market mechanism and the asymmetrical information sometimes give out misleading signals and result in erroneous judgements and even a destructive imbalance between production and consumption. Therefore, the state intervenes in the market with flexibility, correcting market distortions and facilitating market functioning. Over the past 20 years, the working of only one mechanism usually resulted in increased turbulence. Only when the invisible hand and the visible hand functioned together would the economy develop smoothly. A number of arguments and practices have proved the necessity and correctness of this point.

Ninth, under no circumstances should developing countries employ inflation as a policy option. Even if inflation is unavoidable, its potential impact should be measured and controlled. Letting inflation go unchecked is equivalent to suicide. Since China's development has been accompanied by a shortage in supply, the idea of development in a coordinated manner might not have gained enough attention when the economy was growing rapidly. Inflation occurred as a result. A policy mistake arises when stabilisation policy is insufficiently applied and growth is accompanied by inflation. Inflation should not be regarded as a growth stimulus. Once inflation occurs, the government should take measures to contain the inflation within an appropriate limit, i.e. to keep it low. In a country like China, people's living standards are still low and are vulnerable to inflation. Inflation should be kept lower than the growth rate of income. It is possible that the public may tolerate short-term inflation, while any long-term high inflation, from several months to two years, will inflict serious damage on the economy and

probably cause social disturbances unless the government intervenes resolutely.

Finally, in addressing the problem of economic overheating we should take effective measures. As the problem of "excessive eagerness in pursuing economic development" is prevalent in China, economic overheating has not received much attention and the adjustment measures are toothless. The expansionary inflation in the mid-1980s could have been corrected without many adverse consequences. However, the problem was not fully recognised and thus the macro-corrective measures were not sufficient. The subsequent acceleration of economic development only exacerbated the situation. Repeated over and over again was the cycle of inflation-rectifying measures impeding economic development; the economy overheating after the revocation of those measures; and the re-adopting of rectifying measures slowed economic growth once more. A thorough rectification was launched in the autumn of 1988 when the mounting problem culminated in bank runs and rocketing prices, but the ideal moment had passed.

The above are the experience and lessons drawn on the basis of China's economic development over the past 20 years. Since the second half of 1997, insufficient demand has emerged in China as a result of the Asian financial crisis and the economy has become a buyers' market. Other warning signals have also emerged in the financial field. The Chinese government has made timely policy adjustments on the basis of the fundamental principles of macro-adjustment, such as expansionary fiscal policy and appropriate monetary policy, and increasing investments to spur domestic demand. These measures have achieved positive effects. What should be pointed out is that China was able to withstand the Asian financial crisis and achieve stable growth because of the measures aimed at rectifying overheating and reducing economic bubbles, taken several years before the crisis broke out. This proves that macro-adjustment is not rigid, unchangeable, but that it should be carried out, subject to further fine-tuning, taking into account new developments. Constant research and innovation are required especially in financial supervision, the reform of the financial system and financial innovation. In this connection, I would like to express my wish again, namely that the domestic and foreign experts here today will share with us their valuable opinions without reservation, thus contributing to China's stable economic growth.